New Zealand Banking Association
Te Rangapū Pēke

Submission

to the

The Reserve Bank of New Zealand - Te Pūtea Matua

on the

Depositor Compensation Scheme Regulations Consultation Paper

10 May 2024

NEW ZEALAND BANKING ASSOCIATION – TE RANGAPŪ PĒKE
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About NZBA

1. The New Zealand Banking Association – Te Rangapū Pēke (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following eighteen registered banks in New Zealand are members of NZBA:
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   - ASB Bank Limited
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   - KB Kookmin Bank Auckland Branch
   - Kiwibank Limited
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Introduction

NZBA welcomes the opportunity to provide feedback to the Reserve Bank of New Zealand - Te Pūtea Matua (**Reserve Bank**) on its consultation paper "Depositor Compensation Scheme Regulations" (**Consultation**). NZBA commends the work that has gone into developing this document and the technical analysis supporting it.

Contact details

3. If you would like to discuss any aspect of this submission, please contact:

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The DCS regulations should be subject to comment before finalisation, and provided as soon as possible to allow banks to prepare for a positive customer experience at 'go live'

Overview

4. NZBA commends the Reserve Bank for its continued open engagement and industry workshops in relation to the Depositor Compensation Scheme (**DCS**).

5. As we have stated in previous consultations on this topic, it is important that this engagement continues as development of the DCS progresses. This will help ensure the DCS is appropriately tailored to the New Zealand market, that there is a consistency of approach, and an opportunity for clear messaging to the public.

6. As previously noted by industry, we believe that sufficient time for consideration of the requirements and impacts is needed during the development of the DCS regulations in order to provide the best outcomes for customers.[1] We understand the current proposal for finalising DCS regulations is:

   6.1. final DCS regulations will be passed at the end of 2024;

   6.2. no drafts of the DCS regulations will be published before finalisation; and

   6.3. Cabinet papers are expected to be published in due course (but we understand these will not include draft regulation text).

7. The current proposed timeline will provide approximately **6 months** from the time that regulations are published until the time they come into effect, and **no allowance** is provided for industry to comment on those regulations before they are finalised. We note that in December 2023, when the Reserve Bank announced a delay to the implementation of the DCS, the Reserve Bank outlined that key reasons for the delay were to allow time to consult on important policy details and implement secondary legislation. As the industry works towards implementing the DCS in 2025, we emphasise the need for continued clear and open communication from the Reserve Bank (including making the regulations available earlier in the process as discussed below), in order to ensure customers are properly protected once the DCS is operationalised.

Regulations need to be made available earlier in the process this year

8. Noting that deposit takers want to ensure the best experience for customers when the DCS goes live in 2025, we request that the Reserve Bank to be mindful of the following areas of interest as we move towards implementing the DCS:

   8.1. When the DCS goes live in 2025 deposit takers will need to be able to clearly and accurately describe to customers which of their products are covered by the DCS, the extent to which they are covered and the possibility of delays in payment under the DCS for certain products. Deposit takers may also be

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[1] Please see our submission to the Finance and Expenditure Committee on the Deposit Takers Bill here and our submission to the Reserve Bank on the Levy Framework for the Depositor Compensation Scheme here.

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required to publish a list of their protected deposits on their website. This will require deposit takers to have analysed their products and established consistent communications messaging with their frontline staff. We think it is critical that the Reserve Bank help clarify these matters as soon as practicable.

8.2. General public guidance (including details of branding symbols and disclaimers or similar, and consistent lists of ineligible depositors (e.g. government agencies)) will need to be published by the Reserve Bank in advance of DCS commencement, to ensure that the public receives consistent messaging regardless of the deposit taker of which they are a customer. Deposit takers would value the opportunity to have visibility of Reserve Bank messaging, and ensure consistency with their own communications.[2]

8.3. We also noted previously that it may also be necessary to adjust product terms to more clearly fit within the DCS, so that customers have certainty; and Deposit takers with overseas reporting requirements (such as under APS 210) will need to be able to report on the extent to which the deposits they hold are protected.[3]

In addition to those previously raised areas of interest, NZBA further notes that the Reserve Bank:

8.4. Ensure that there are clear DCS payment waterfalls (that is, which products would be paid out first, and the fact that relevant arrangements payments are to be made to account holders rather than beneficiaries) and describing the interaction with Open Bank Resolution (**OBR**) so that customers can be clearly informed of how a payout is likely to function in the broader context of a deposit taker failure. This will be of particular concern for customers who hold multiple accounts relating to the same product, where the application of the DCS and OBR regimes may result in different outcomes.

8.5. More generally, the Reserve Bank provide a clear description of how relevant arrangements will be treated, what will (and will not) be categorised as relevant arrangements, and what customers are required to do in relation to those relevant arrangements. This will be required in advance of the implementation of the DCS in mid-2025 (referred to as T0) so that deposit takers can provide clear and consistent communications to customers. In this respect we see it as critical for the Reserve Bank to finalise and share public facing guidance as soon as possible to enable deposit takers to give consistent communications. Customers (and, by extension, the beneficiaries of relevant arrangements held by customers) will be keen to understand what custody/beneficiary or similar accounts are not treated as relevant arrangements (as discussed further below), and what the implications are. As noted at paragraph 28.3 below, this will require coordination between deposit takers, customers providing information and the Reserve Bank.

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[2] Regarding the importance of communications, we refer in particular to our comments at paragraphs 14 to 16 of the 2023 Submissions.

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8.6. In relation to the proposed exemption for branches (discussed further below), such banks will need to understand the exact requirements of the exemption well before T0, particularly if this practically means that they have to accelerate the divestment all of their relevant 'retail' customers ahead of T0, given the need to minimise disruption for those customers.

8.7. We understand payout arrangements for non-OBR deposit takers are expected to be in place by T0, with some deposit takers anticipated to be in place as payout agents to assist with this. We note there has been limited consultation on how payout arrangements will operate and in particular the role of deposit takers as payout agents. Accordingly, we expect this will require significant additional work for industry to help implement, which cannot be materially progressed until the DCS regulations in relation to this have been significantly advanced, including several matters not included in this Consultation (such as arrangements for mass on-boarding of customers, as discussed under "Other" below).

9. NZBA submits that the Reserve Bank should look to engage with industry as soon as possible on the above areas of interest. We want to ensure positive outcomes for customers once the DCS goes live and see early and consistent engagement from the Reserve Bank on the above areas as a critical step towards achieving that outcome.

An exposure draft needs to be provided for review and comment

10. From a process perspective it is also important that industry and others have an opportunity to consider and comment on the text of the DCS regulations before they are finalised. The regulations will address a range of important inter-related technical matters, that will need to be considered in relation to expected customer interactions. Some of the expected content of the regulations (such as payment waterfalls and interaction with OBR) have not been consulted on to any material extent.

11. Finalising the regulations without allowing an opportunity to comment will create a very high risk of error and unintended consequences, with no time to fix such matters before T0.

12. The key benefit of depositor protection schemes is the confidence they provide depositors, reducing liquidity risks. If the DCS does not work properly at commencement, so customers are left confused as to how it applies, or customers are not aware of the DCS, that key benefit will be lost. Rebuilding that lost confidence could take a considerable amount of time.

13. NZBA therefore submits that an exposure draft of the DCS regulations is made available as early as possible this year, ideally by mid-year. Even if an exposure draft is not available until later in the year, for the above reasons NZBA submits that there still needs to be sufficient time for industry to comment on the draft before the DCS regulations are finalised. It is critical that industry has the opportunity to review and comment on the DCS regulations before they are finalised at the end 2024, even if this consultation is somewhat limited. Additionally, given the condensed timeframe for the DCS regulations to be implemented, the Reserve Bank needs to have a clear plan for meaningful ongoing engagement with deposit takers following the finalisation of DCS regulations to ensure that any issues that arise in connection with the finalised DCS regulations are dealt with ahead of T0.

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Submissions on Chapter 1 (DCS levies)

Initial levy base

14. We appreciate the further detail on initial levy base calculation proposals that the Reserve Bank has provided as part of the Consultation. In this regard:

    14.1. We note that the levy base calculation for smaller deposit takers (including credit unions, building societies and finance companies) is a broader estimation, as it uses less granular data and more assumptions. We submit that the Reserve Bank should consider how it would fairly address a situation in which it was found that such broad estimations considerably underestimated the levy base of relevant deposit takers.

    14.2. As a related point, customer behaviour may also change significantly prior to 2028. Although we generally agree that the levy base calculations should remain unchanged until 2028, we submit that if material changes in customer behaviours are observed and there is evidence of moral hazard taking place, the Reserve Bank should act immediately to review and amend the levy framework and methodology to address this.

15. Based on comments made by the Reserve Bank industry is proceeding on the basis that relevant arrangements will not be categorised as such (i.e. they would be included and treated as 'standard' deposits) for initial levy base calculations. This is based on the comments made by the Reserve Bank during the workshops in August 2023 (slide 27 of the Slide Pack) alongside recent workshops on the Consultation, and at footnote 3 of the Consultation. On that basis we understand that there is no intention to require deposit takers to flag or track relevant arrangements for the purpose of the DCS prior to SCV requirements coming into force.

Levy approach

16. NZBA supports the Reserve Bank's proposal to use a composite risk-based approach to setting DCS levy rates. As discussed in more detail in previous submissions:[4]

    16.1. taking a risk-based approach is preferred to ensure that levies are set on an equitable basis; and

    16.2. taking a flat rate approach could incentivise risk-taking behaviour.

17. NZBA makes no comment on the proposed formula for determining individual risk scores. We understand members may submit separately on these matters. However, NZBA does support a review of the risk score formula in 2028, once the system has been in place for a few years and final standards are available to review against.

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[4] See paragraph 19 of the 2023 Submissions.

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Submissions on Chapter 2 (Operational aspects of levies)

18. NZBA supports the Reserve Bank's proposal to charge levies annually in arrears.

19. However, NZBA submits that deposit takers should have clarity about what risk bands they fall into in advance of the relevant year. It is desirable to ensure the certainty and predictability of levy rates. This could be achieved by setting risk bands in advance using existing datasets (e.g. the Reserve Bank sets risk bands for 2027 in mid-2026). This will provide predictability and certainty to deposit takers as to the likely size of their levy-related costs.

20. NZBA makes no comment on the use of OCR+4% rate for late payment of the levy. However, we submit that clarity is needed around its intended application to reassessments. In particular, we consider that the rate should not be applied on a 'back-dated' basis where 'late' payment is due solely to a reassessment determining that more was payable for a particular year than initially invoiced. This appears to be consistent with sections 235 and 237 of the Deposit Takers Act 2023, which provide that a levy is due for payment no earlier than 30 days after it is invoiced, and that interest may be payable on an unpaid levy.[5]

Submissions on Chapter 3 (DCS Scope)

21. NZBA supports the proposed list of protected products (i.e. 'standard' current/savings/term deposit accounts together with credit balances on revolving home loans, revolving credit facilities, and credit cards), and the exclusion of transferable products given the complexity they would add.

22. NZBA also supports the proposals to make payment of amounts to the account holder (with the exception of bank-sponsored PIEs, as discussed in relation to relevant arrangements below).

23. In relation to the proposed approach to amounts held on trust (page 33 of the Consultation):

    23.1. We agree with the general proposal to pay the account holder, rather than beneficiaries. This will help minimise the possibility of unintended consequences. However, we consider there may need to be backstop provisions that allow payment to a beneficiary where directed by a Court or similar (for instance where the trustee fails to act).

    23.2. Further clarity of the types of trust covered by the DCS (and eligible for up to $100,000 in compensation) is needed. In particular:

        (a) NZBA supports the exclusion of non-express trusts. However, we believe there is still likely to be operational uncertainty around the

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[5] If, despite our submission above, the OCR+4% rate is applied on a back-dated basis to reassessments, then it would also be necessary for the fund to pay a relevant deposit taker if a reassessment determined that less was payable than initially determined (similar to the Inland Revenue's application of 'use of money interest' to overpayments). This would add significant complexity to management of the fund (and again may be difficult to achieve as the Deposit Takers Act 2023 does not explicitly allow for such payments from the DCS fund).

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treatment of statutory trusts. Therefore, a list of trusts created by statute to be covered should be provided for clarity (in addition to the construction retention money trusts provided in the Consultation), and the evidence requirements for such trusts. We expect this may be provided in separate guidance rather than the text of the DCS regulations. Such a list would support deposit takers to help customers identify such trusts, and provide clear communications on what accounts are/are not covered.

(b) We also query how deceased estates are expected to be treated (noting estates are briefly mentioned in the Consultation), where the account holder is deceased.

24. Consideration should also be given to clarifying the coverage of the following examples where funds are held on behalf of beneficiaries but not governed by underlying legislation:

24.1. budget advisory services for intellectually disabled customers;

24.2. amounts held by customers who are ineligible for protection in their own right (such as tenancy bonds held by government agencies);

24.3. treatment of suspense accounts (such as unclaimed money accounts); and

24.4. funds held by body corporates.

25. We note there has been some indication in the Consultation and workshops that deposit takers will be expected to use 'best endeavours' in respect of customer identification in the interim between T0 and 2028, when single customer view (SCV) obligations come into force (referred to as T1). Our understanding is that this is not a legal requirement and industry is proceeding on this basis. This understanding is consistent with communications from the Reserve Bank, including messaging during workshops and bilateral industry engagements where the Reserve Bank has confirmed that in the event of a bank failure in the period between T0 and T1, the failed deposit taker need provide its data on an "as is, where is" basis, and systems changes were not expected at that point in time. NZBA's view is that any such expectations should not be a legal obligation included in the DCS regulations (or standards in advance of T1). Deposit takers will need to work towards T1 in a timely manner in any event.

26. The Reserve Bank needs to be clear in how it communicates its expectations around engagement with industry on T1 readiness. The time and resources required to meet milestones for T1 readiness will be intensive and the Reserve Bank must be clear in its expectations and provide ample time frames to engage with deposit takers during this period.

27. Additionally, the Reserve Bank should provide clarity to deposit takers on their expectations for the nature of type of data they expect deposit takers to hold at T0. Noting the significant technological challenges posed towards building T1 capability, there is a need for prescriptive clarity on what the data the Reserve Bank is expecting deposit takers to hold and track at T0. Further there is a need for clarity on how that data is to be transmitted to the Reserve Bank.

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Submissions on Chapter 4 (Relevant arrangements)

28. NZBA generally supports the Reserve Bank's proposed approach to defining relevant arrangements, but we note the following:

    28.1. We understand that relevant arrangements do not need to be flagged/tracked by deposit takers before T1, however this is not stated in the Consultation and should be clarified – i.e. deposit takers should not be under an obligation to flag/track relevant arrangement accounts for DCS purposes before T1 (although deposit takers will of course need to build capability over the next few years to ensure they are compliant by T1). We emphasise the difficulty and impracticality of flagging these arrangements before T1, particularly without an SCV standard in place.

    28.2. In connection with this point, the NZBA strongly disagrees with the statement in the Consultation that the impact of identifying such accounts is 'low' (page 44 of the Consultation). While in many cases account records or names may indicate the existence of a relevant arrangement, these may not be stored in a consistent manner that is searchable/retrievable for DCS purposes, and may not be complete, as relevant arrangements will be a new data point for deposit takers. We expect that in many cases customers will need to advise deposit takers of relevant arrangements after T0, and significant work may be required to update IT systems to record such information. Deposit takers will need to rely on the accuracy of such notification from the customer, as generally speaking, it will not be practical for deposit takers to separately confirm the legal nature of the account for the account holder.

    28.3. We understand from the Consultation that it would be the responsibility of the Reserve Bank to identify and calculate entitlements for beneficiaries under relevant arrangements, using records provided to the Reserve Bank by the relevant account holders (and that the Reserve Bank would also take into account any earlier direct entitlement pay-out). We believe this is the correct outcome (as it will not generally be possible for deposit takers to do this on a continuous basis) and submit that this should be expressly clarified in the DCS regulations. This raises the issue as to how these decisions are communicated to account holders. While industry would expect the Reserve Bank to take the lead with such communications, they will need to be consistent with deposit takers own communications in relation to the DCS. This will require a level of co-ordination and flexibility of approach, given that that deposit takers will take differing approaches on the issue.

29. As an exception to the general rules for relevant arrangements discussed above, bank-sponsored PIEs should be expressly treated the same as ordinary deposits, including that payouts are made to the PIE investor (rather than the direct account holder) and on a short timeline. This is important for clear messaging and consistency with the general market understanding of these products. We note that this may not be appropriate where the PIE investor is another relevant arrangement, i.e. where funds held in trust are invested in PIEs.

30. We note the Reserve Banks intends to treat construction company retentions as trusts, rather than as relevant arrangements. We are aware that retention accounts may hold

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funds for multiple persons across multiple construction contracts.[6] The Reserve Bank should be aware of this, and if necessary reconsider the treatment of construction company retentions.

Submissions on Chapter 5 (Exempting Deposit Takers from the DCS)

31. NZBA supports exempting 'wholesale-only' branches of overseas banks from the DCS. We agree that the protection offered by the DCS is unlikely to be particularly significant for wholesale depositors (and we note that such customers would be equipped to assess and make their own decision on whether they would like to keep their deposit with a branch or with another bank protected by the DCS).

32. We are concerned that there is only a very short amount of time if branches were to divest retail customers before T0, and that branches may not be able to significantly advance this work until the conditions of the exemption are known. Given timing, we submit that:

    32.1. The exemption should focus solely on deposits and revolving credit facilities (and not other retail business that may be conducted by the branch), given this is the focus of the DCS. The exemption conditions should also disregard debt securities that would not otherwise be protected deposits (for example, bonds issued by the branch may have been traded to retail investors over time, which the issuer cannot control or directly influence).

    32.2. The exemption should also allow for the holding of a de minimis level of retail deposits after T0 (which would include for instance any existing term deposits that are not set to mature until after T0). This is required practically as branches manage the divestment of retail customers, which will be subject to existing contractual terms and may need to be discussed individually with each relevant customer.

    32.3. While the outcome of the Reserve Bank's Branch Policy Review briefly describes the expected definition of 'wholesale investor' for bank branch dealings (referring to clause 3(2) and 3(3)[7] of Schedule 1 to the Financial Markets Conduct Act 2013 (**FMCA**)), we expect that the final test will be tailored to the circumstances of bank dealings generally (rather than investment in financial products, which is the focus of the original FMCA test).

    Similarly, we submit that the 'wholesale investor' test for the DCS branch exemption will need to address:

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[6] For example see the examples of retention accounts on page 22 of MBIE's guidance document on construction company retentions under the Construction Contracts Act 2002.

[7] Refer to page 39 of the Regulatory Impact Statement dated 7 November 2023, which states that "The final policy decision is that branches only undertake business with wholesale investors, as defined in Clause 3(2) and 3(3), Schedule 1 of the FMC Act." We note that this Consultation refers only to clause 3(2), but this seems to be based on an earlier consultation document under the Branch Policy Review, from August 2022.

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(a) When the wholesale investor test is applied (eg when is the 'large' test applied for existing customers), and what timeframe is permitted for a branch to divest a wholesale customer who later becomes retail. Clear operational guidance will be needed, and the mechanics will be drafted to ensure that they can be routinely applied in all relevant circumstances, without giving rise to unnecessary risk of non-compliance over time (for instance, due to changing circumstances of the relevant customer).

(b) Banking of corporate groups (and, in particular, including customers who are wholly-owned local subsidiaries of large multinational corporate groups). We expect this would be achieved by referring to person who are wholesale investors under clause 9 of Schedule 1 to the FMCA because they are controlled by a wholesale investor under clause 3(2) or 3(3).

Clarity on these matters is required urgently so that branches can ensure they satisfy the exemption requirements by T0, as discussed above. This may mean that the test for this purpose will need to be finalised before the test for wholesale bank branch dealings more generally.

32.4. We submit that, as an alternative approach, the Reserve Bank should consider allowing branches more time to divest retail customers (for instance, 12 months after T0), provided they provide clear correspondence to each retail depositor and maintain relevant website disclosure after T0. This would allow more time to finalise the matters mentioned above and for branches to then implement them.

Submissions on Chapter 6 (In-flight payments)

33. While NZBA generally supports the Consultation proposals regarding treatment of in-flight payments, it notes that there is significant complexity in the treatment of in-flight payments, especially in the context of trying to achieve the most equitable outcome for customers. This is particularly so in respect of the treatment of card payments, where timing issues become more of a consideration. Given the technical and complex nature of this, it is important that there is industry consultation before DCS regulations on this issue are finalised. We submit that further technical detail should be provided as soon as possible (including as to the interaction with OBR).

Other key matters

34. As noted above, there are a number of aspects of the expected DCS regulations that are not addressed in the Consultation. While we understand some of these matters are not expected to be in place by T0 (such as provisions relating to temporary high balances), others will need to be in place to support T0 deliverables such as payout mechanics. In particular, as previously submitted[8] this includes:

34.1. application of customer due diligence (**CDD**) requirements when mass on-boarding;

[8] See paragraphs 24.2, 24.5 and 24.6 of the 2023 Submissions.

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34.2. potential impact on staff and infrastructure;

34.3. payment waterfalls; and

34.4. privacy obligations relating to sharing of customer data more generally.

35. Related to the topics of this Consultation, NZBA notes the intention for a consultation on SCV standards in May this year. As an initial comment, those standards will need to reasonably address similar matters to those discussed above, including that for some data, accuracy/quality will be difficult or impossible for deposit takers to confirm.

36. In addition, we expect that significant testing will be required by industry prior to the implementation of the SCV standards in 2028. In this context we request that, as part of the Reserve Bank's upcoming consultation on the SCV standards, the Reserve Bank provides some detail, and an updated road map, on how it intends to implement the SCV standards. This should include provision in the timelines for any testing that the Reserve Bank expects deposit takers to undertake.

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